***United States Court of Appeals***

***for the Second Circuit***


# REPLY BRIEF

76-5004



UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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ALAN B. MILLER, as Trustee in Bankruptcy of
AMERICAN IBC CORP., Bankrupt,

Plaintiff-Appellee,

against

WELLS FARGO BANK INTERNATIONAL CORP.,

Defendant-Appellant.

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ON APPEAL FROM THE UNITED STATES DISTRICT
COURT, FOR THE SOUTHERN DISTRICT OF NEW YORK

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# REPLY BRIEF OF APPELLANT WELLS FARGO BANK INTERNATIONAL CORP.

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## PRELIMINARY STATEMENT

Appellant submits this brief in reply to Appellee's unnecessarily voluminous answering brief and in support of its appeal from the decision of the District Court that the repayment of the two loans at issue in this case constituted voidable preferences. Although the business facts and background of the two loans are somewhat complex, the essential facts necessary to determine the issues on this appeal are relatively straightforward.

A very basic problem with the District Court's decision is its refusal to recognize present-day banking practices and commercial reality. As the record makes clear, the telex is customarily used to transmit funds in international banking transactions. Because of the safety and reliability of the test key code system, banks throughout the world telex many millions of dollars daily to each other across the globe through the various clearing banks. Because of their trust in the system and their practice of reliance on tested telex instructions from other banks, they are willing to commit their funds to this system. Perhaps one tribute to the safety and reliability of the telex system is the absence of case law on the subject.

The first transaction is a classic illustration

of a secured loan. AIBC agreed to give the New York Bank a security interest in a Swiss franc time deposit which would be lodged with the New York Bank's Luxembourg affiliate. The Swiss francs were deposited with the Luxembourg affiliate which accepted the funds under the express assumption that they would be used as collateral for the New York Bank's loan. Furthermore, the New York Bank notified its Luxembourg affiliate that the time deposit was collateral for its loan to AIBC. Upon maturity, the Luxembourg affiliate transferred the Swiss franc proceeds of the time deposit to SCB with explicit instructions to remit the dollar equivalent to the New York Bank. SCB followed the Luxembourg affiliate's instructions as it was required to and transferred the dollar equivalent to the New York Bank. Under all legal precedent and logic, this is a secured transaction.

Some bank accounts are represented by "indispensable instruments", such as a savings bank passbook. International time deposits and commercial accounts typically are not. In this case, it is uncontested that the Luxembourg affiliate never issued any such indispensable instrument.* The Trustee apparently concludes that if the Luxembourg affiliate had filled out a passbook and then retained it on behalf of the New York Bank, a valid pledge would have existed. The Trustee has failed to suggest a single logical

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* Unless the telex key code is considered an indispensable instrument.

reason to distinguish between notice of a security interest to a holder of an indispensable instrument when one has been issued and notice to the only party who has the power to issue an indispensable instrument when one has not been issued.

What was issued by the Luxembourg affiliate was a confirmation of deposit -- a simple receipt. Reading the receipt shows that it did not entitle the holder to do anything. Under the law, creditors are not entitled to rely on it. The logic behind this is sound. A receipt may be retained by the depositor even though he has withdrawn the funds. The District Court recognized that it was only a receipt but then failed to realize that under New York law creditors were not entitled to rely on it. It is this type of fundamental flaw in the District Court's reasoning that causes the errors in the District Court's opinion.

The question of release of the collateral is equally straightforward. The remittance instructions were issued by the Luxembourg affiliate, the agent of the New York Bank. In fact, the very wording of the instructions had been dictated to the Luxembourg affiliate by the New York Bank. [Ex. A (E 174)] These remittance instructions controlled the transfer of the funds. The District Court itself conceded that if SCB was the Luxembourg affiliate's agent, the New York Bank's security interest would be continuous. [Opinion, A 182, n. 17]

What the District Court failed to realize was that a bank transmitting funds (SCB) is, as a matter of law, the agent of the party sending them (the Luxembourg affiliate). Therefore, the New York Bank never lost possession and control of the collateral.

However, completely apart from this agency relationship, the New York Bank retained a continuous security interest. A pledgee may release collateral to a third party for the temporary purpose of sale or exchange. The cases impose no requirement that the third party receive notice of the pledgee's security interest. The essence of this principle is that the relinquishment of possession has been for a specific and temporary purpose. This is the test when the collateral is released to the pledgor. There is no reason to impose a stricter test when collateral is transferred, not to the pledgor, but to a third party for the purpose of sale or exchange.

In the second transaction, the District Court's critical error was its failure to recognize that under §60 of the Bankruptcy Act, the August 29, 1973 telex only needed to give SCB a lien that would have precluded third parties from obtaining a superior interest. The fact that AIBC may have retained nominal title after August 29, 1973 is irrelevant. When SCB transferred the dollars to the New York Bank on November 19, 1973, all that happened was that one secured creditor was substituted for another. The balance sheet of AIBC remained unaffected.

## POINT I

### UNDER NEW YORK LAW, THE CONFIRMATION OF DEPOSIT ISSUED TO AIBC WAS A MERE RECEIPT - AIBC POSSESSED NO INDICIA OF OWNERSHIP OF THE TIME DEPOSIT WITH THE LUXEMBOURG AFFILIATE - NO CREDITOR COULD HAVE BEEN MISLED IN ANY WAY

A crucial and persistent misapprehension running through both the opinion of the District Court and the brief of the Trustee is the legal significance of a bank deposit receipt. Both the District Court and the Trustee conclude that the receipt given to AIBC following the establishment of the time deposit at the Luxembourg affiliate left AIBC with the deceptive appearance of complete and unencumbered ownership of the time deposit. One need only read the receipt to see that it gives the holder no authority to do anything. It is a deposit slip only. [Ex. 3 (E 5)] The only relevant authority, a New York Court of Appeals case, First National Bank v. Clark, 134 N.Y. 368, 372, 32 N.E. 38 (1892), which is discussed in Appellant's brief, conclusively establishes that a reasonable creditor is not entitled to rely in any way on AIBC's possession of the confirmation of deposit in the instant case. [Appellant's Brief, pp. 25-26] The Trustee does not address himself to this authority in his answering brief.*

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* The document issued to AIBC was nothing more than a receipt. The fact that it was referred to by some other name (a confirmation of deposit or contract) does not alter either its nature or legal significance. First National Bank v. Clark, supra.

The significance of this uncontested principle is crucial since both the District Court and the Trustee premise their conclusions on the mistaken assumption that AIBC's possession of the confirmation of deposit gave to AIBC false "indicia of ownership" of the time deposit and that such indication could be misleading to creditors. Thus, the District Court erroneously held that an otherwise valid pledge of the time deposit would not be valid against the Trustee. [Opinion, A 137, 142, 160-61] Since potential creditors were not entitled to rely on the receipt, the Luxembourg time deposit was validly pledged.

Similarly, one of the major but unsupported arguments of the Trustee is that any security interest in the time deposit was in the nature of a secret lien and, as such, repugnant to the policies and purposes of the Bankruptcy Act. Again this argument erroneously presupposes that AIBC had some "indicia of ownership" of the time deposit in the first place.

## POINT II

### RECOGNIZING THAT THE TWO LETTERS AND THE GENERAL PLEDGE AGREEMENT CONSTITUTED AN ASSIGNMENT THE TRUSTEE NOW ASSERTS THE NOVEL AND INCORRECT PROPOSITION THAT A BANK ACCOUNT MAY ONLY BE ASSIGNED BY THE DELIVERY OF AN INDISPENSABLE INSTRUMENT

The District Court recognized that a security interest in a bank deposit may be effected by a written assignment.* Its critical error was its failure to recognize that an assignment may be for purposes of security with title remaining in the assignor.** Maloney v. John Hancock Mutual Life Insurance Co., 271 F.2d 609 (2d Cir. 1959); Malone v. Boistein, 151 F. Supp. 544 (N.D.N.Y. 1956), aff'd, 244 F.2d 954 (2d Cir. 1957); Fairbanks v. Sargent, 117 N.Y. 320, 332 333 (1889); In re City of New York, 197 Misc. 154, 95 N.Y.S.2d 26 (Sup. Ct. 1950); 3 N. Y. Juris., Assign., §50 (1958).

Apparently recognizing this error in the District Court's reasoning, the Trustee now bases his argument primarily upon the contention that a security interest in a bank account may only be assigned by the transfer of an "indispensable instrument", such as a passbook. When a passbook does not exist, according to the Trustee, an assignment is impos-

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* The Trustee's contention that the question of assignment has been first raised on appeal is incorrect. [Opinion, A 145; Defendant's Post-Trial Reply Memorandum, pp. 7-9]

** See the District Court's opinion at A 151.

sible. [Appellee's Brief, p. 48] This argument was rejected by the District Court and is totally unsupported by either law or logic.

A. The District Court Correctly Held That A Security Interest In A Bank Deposit May Be Transferred By A Written Assignment

Under New York law, a chose in action may be assigned. [Opinion, A 145] N. Y. Gen'l Oblig. Law, §13-101 (McKinney's 1964); Stathos v. Murphy, 26 App.Div.2d 500, 276 N.Y.S.2d 272 (1st Dept. 1966), aff'd, 19 N.Y.2d 883, 281 N.Y.S.2d 81, 226 N.E.2d 880 (1967); 3 N. Y. Juris., Assign., §12. Time deposits, as choses in action, are also assignable. [Opinion A 145] Myers v. Albany Savings Bank, 270 App.Div. 466, 60 N.Y.S.2d 47[illegible] (3rd Dept.), aff'd, 296 N.Y. 562, 68 N.E.2d 866 (1946); Walton v. Piqua State Bank, 204 Kan. 741, 757, 466 P.2d 316, 329 (1970).

The common method of assigning a chose in action is by agreement. Stathos v. Murphy, 26 App.Div.2d at 503, 276 N.Y.S.2d at 279. In addition to assigning a chose in action by agreement, the courts have permitted an assignment to be effected through the transfer of an indispensable instrument when one exists to the assignee.

The Trustee has cited numerous cases which stand for the proposition that a bank deposit, like other choses in action, may be assigned by the transfer of an indispensable instrument, such as a passbook, when one exists. [Appellee's Brief, pp. 48-49] None of these cases holds that this is the only way in which a bank account may be assigned. The Trustee

has failed to cite any authority which holds that a bank account may only be assigned by the transfer of a passbook or some other indispensable instrument. In addition, the Trustee has failed to offer any logical distinction between a bank account as a chose in action and choses in action in general, which would justify a holding that a bank account may not be assigned by a written agreement. The simple fact is that there is no distinction that demands a different treatment.

Both the District Court's decision in this case and the other courts that have ruled on this question have concluded that a bank account may be assigned by a written agreement. [Opinion, A 145] Walton v. Piqua State Bank, supra; Watson v. Stockton Morris Plan Co., 34 Cal. App. 2d 393, 405, 93 P.2d 855 (1939).

In this case, the District Court correctly pointed out that an assignment does not require possession of the underlying obligation. [Opinion, A 145] "Thus the issue of the indispensable instrument doctrine appears irrelevant to the assignment asserted here." [Opinion, A 183, n. 18]

In Walton v. Piqua State Bank, supra, the Court specifically found that an assignment of a depositor's account could be effected by delivery of the passbook or a formal written assignment of the account.

> "We conclude that a savings account, being a chose in action, is a proper subject of a pledge and may be placed in the possession

> of the pledgee by delivery of the passbook or by a written assignment of the account to the extent of the debt . . ." 466 P.2d at 329 (Emphasis supplied)

The Trustee claims that the Court in Walton held that "delivery of an indispensable instrument is essential to a transfer of rights in a bank account." [Appellee's Brief, p. 50] What the Court actually held is that a transfer of an indispensable instrument, when one exists, is essential for a pledge of a bank account. Subsequently, as stated in the above quotation, the Court found that a transfer of a security interest in a bank account may also be effected through a written assignment.

In Watson v. Stockton Morris Plan Co., supra, the Court stated:

> "A savings account being a chose in action may be assigned with or without a delivery of the passbook though such assignment is best evidenced by a delivery of the passbook together with a formal written assignment of the account . . ." 34 Cal.App.2d at 405

The above cases accept the validity of a written assignment even when an indispensable instrument exists and arguably might be used to mislead creditors. When an indispensable instrument does not exist, as in the present case,* a written assignment becomes the best and only way to assign a security interest in a bank deposit.**

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* Unless of course the Court finds that the telex key code which was in the possession of the New York Bank was an indispensable instrument.

** When an indispensable instrument has not been issued, a pledge of the account may still be effected by notifying the bank holding the account of the pledgee's security interest.

If the Trustee's argument is correct, when an indispensable instrument has not been issued (as is usually the case with commercial accounts, such as statement accounts, and foreign bank deposits), it would be impossible to assign an interest in the account. Commercial accounts are most frequently used by banks to secure loans.

B. The April 30 And May 2, 1973 Letters Constituted A Valid Assignment Of A Security Interest In The Luxembourg Time Deposit To The New York Bank

The question of whether the April 30 and May 2, 1973 letters constituted an assignment is controlled by New York law. [Opinion, A 136, 180, n. 11] Appellant's initial brief discusses numerous New York cases which establish that the language in these letters constitutes a valid assignment. Griffey v. New York Central Insurance Co., 100 N.Y. 417, 422, 3 N.E. 309, 311 (1885); Frensdorf v. Stumpf, 30 N.Y.S.2d 211 (Sup. Ct. 1941); Estate of Palmer, 53 Misc.2d 217, 278 N.Y.S.2d 352 (Sur. Ct. 1967). The New York Bank also established that this result was in accord with the general test applied by the New York courts in determining whether an assignment exists. The Trustee has not even attempted to distinguish these cases.*

The two cases cited by the Trustee, Fisher v. Liberty National Bank & Trust Co., 53 F.2d 856 (S.D.N.Y. 1931), aff'd, 61 F.2d 757 (2d Cir. 1932), cert. denied, 288 U.S. 611 (1933)

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* Apparently the Trustee recognizes that once it is realized that an assignment may be for purposes of security, it is clear that these letters constitute an assignment under New York law.

and United States v. Bush Construction Co., 176 F. Supp. 524, 526 (E.D.N.Y. 1959), have nothing to do with the question whether language in an agreement constitutes an assignment. They are addressed to the question of when, in the absence of an agreement, an assignment may also be found from the instructions transmitted to the obligor. For this reason, they are completely inapplicable. In addition, the Trustee's description of the instructions which were sent by the Luxembourg affiliate, not AIBC, is incorrect. The New York Bank instructed the Luxembourg affiliate to remit the Swiss francs to SCB and to order SCB to send the dollar equivalent to the New York Bank. [Ex. A (E 174)] The Luxembourg affiliate followed the New York Bank's instructions. [Ex. AD (E 221)]

Furthermore, as the District Court correctly recognized, an assignment does not require possession of the underlying obligation as does a pledge. [Opinion, A 145] Therefore, even if it is assumed that the collateral assigned was temporarily released to be remitted to the New York Bank,* the New York Bank's security interest under the assignment would still have been continuous. If one need not obtain possession of the underlying obligations in the first place to be secured, the temporary release of possession obviously does not result in a loss of the assignee's security interest.

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* It is the New York Bank's position that the collateral was never released since SCB was acting as the agent of the Luxembourg affiliate which was the party sending the funds. See, Point IV, infra.

Finally, the secret lien argument suggested by the Trustee is a red herring and has absolutely no relevance to the facts of the present case. The District Court did mention that New York common law did not appear sensitive to potential creditors since notice of the assignment to the obligor is not required for perfection of the assignee's interest under New York law.* This problem is irrelevant here because the obligor (the Luxembourg affiliate) was notified of the New York Bank's security interest. [Opinion, A 139]**

Under the common law, potential creditors are protected by the assignee's giving notice of its security interest to the obligor (the Luxembourg affiliate). Potential creditors may then check with the obligor to see if the asset in question is unencumbered. Even though New York law does not require this step, the New York Bank did in fact give such notice. As was demonstrated in Point I, supra, the fact that AIBC retained a confirmation receipt could not mislead creditors.

The exchange of the April 30 and May 2, 1973 letters assigned to the New York Bank a security interest in the Luxembourg time deposit. Under New York law, this security interest was perfected when made. Potential creditors were in fact protected because the obligor (the Luxembourg affiliate) was

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* However, as the District Court recognized, the Bankruptcy Act itself makes state law controlling on the question of when a security interest is to be deemed perfected. [Opinion, A 136]; see also, McKenzie v. Irving Trust Co., 323 U.S. 365 370 (1945)

** The District Court found that the New York Bank sent the Luxembourg affiliate a copy of the May 2, 1973 letter in which AIBC assigned to the New York Bank a security interest in the time deposit. [Opinion, A 139; Ex. H (E 185)]

notified of the New York Bank's security interest. Therefore, the payment of the proceeds of the time deposit to the New York Bank may not be recovered as a preference.

C. It Is Uncontroverted That A Security Interest In The Luxembourg Time Deposit Was Assigned To The New York Bank Pursuant To The 1970 General Pledge Agreement

Under the General Pledge Agreement ("the Agreement") AIBC "assigned" to the New York Bank "all money and property that came into its custody and control." [Ex. F (E181)] The District Court recognized that the Agreement might very well constitute an assignment of the Luxembourg time deposit since the Luxembourg affiliate, which had possession and control of the deposit, was acting as the New York Bank's agent. [Opinion, A 139] However, the District Court erroneously found that pursuant to the Agreement the assignment terminated when the New York Bank lost "possession, custody, or control" of the funds by transferring them to SCB for the purpose of exchange into dollars which were to be remitted to the New York Bank. [Opinion, A 152] The New York Bank, in its initial brief, pointed out that the District Court failed to recognize and apply language in the Agreement which explicitly provided for the exchange and transfer of the collateral. [Appellant's Brief, p. 22]

None of the above points has been controverted by the Trustee. Furthermore, even if the Agreement did not provide for the exchange and transfer of collateral, SCB was the agent of the Luxembourg affiliate which issued the remittance instructions. See Point IV, infra. Therefore, the collateral and its proceeds were at all times in the possession and control of an agent of the New York Bank.

## POINT III

### THE TRUSTEE CITES NO PERSUASIVE AUTHORITY IN DEROGATION OF THE EFFECTIVENESS OF THE PLEDGE OF THE LUXEMBOURG TIME DEPOSIT AS SECURITY FOR THE FIRST LOAN

The time deposit with the Luxembourg affiliate was validly pledged to the New York Bank as security for the first loan.

First, the Luxembourg affiliate had possession of the Swiss francs which comprised the time deposit. In the absence of an indispensable instrument, notice of the security interest to the bank holding the time deposit is sufficient to perfect a pledge. The Trustee has yet to suggest a valid reason for distinguishing between notice to the holder of an indispensable instrument when one has been issued and notice to the only party who has the power to issue an indispensable instrument when one has not been issued. Nor has the Trustee suggested a single reason why a time deposit may not alternatively be treated as goods for the purpose of a pledge. See, Appellant's Brief, pp. 29-32.

Second, the New York Bank had possession and control of the telex key code which in this case served the function of an indispensable instrument.

Third, the New York Bank, by virtue of the April 30 and May 2, 1973 letters and the General Pledge Agreement, had the right to foreclose at any time on the time deposit.

A. A Pledge Was Effected By Delivery Of The Swiss Francs Comprising The Time Deposit To The Luxembourg Affiliate And Notice To The Luxembourg Affiliate Of The New York Bank's Interest In The Account

The Trustee recognizes that the delivery requirement of a pledge can be satisfied under certain circumstances by a transfer of possession of the collateral to a third person. (Appellee's Brief, p. 46) However, the Trustee asserts that the third person acquiring possession of the collateral must be an agent of the pledgee and that in the instant case the Luxembourg affiliate was not acting as agent for the New York Bank.

First, the district court found that the Luxembourg affiliate was in fact the New York Bank's agent. [Opinion, A 180, n. 12] Second, the law of New York is clear that an agency relationship between the pledgee and the third party holding the collateral is not necessary to establish a pledge.*

The authorities establish without a doubt that notice of the pledgee's interest to a third party who has possession of the collateral by either the pledgor or the pledgee is sufficient to establish a pledge. Gins v. Mauser Plumbing

*Careful examination of Note 12 to the district court's opinion establishes that the district court either found an agency relationship between the Luxembourg affiliate and the New York Bank or held that notice alone was sufficient. [Opinion, A 180, n. 12]

Supply Co., 148 F.2d 974, 977 (2d Cir. 1945); Barney v. Rigby Loan & Investment Co., 344 F.Supp. 694 (D. Idaho 1972); In re Copeland, 391 F.Supp. 134, 151 (D. Del. (1975) 53 N.Y. Juris., Secured Transactions, §121 at 421 (1967); Restatement of Security, §8 (1941); N.Y. U.C.C. §9-305 (1964) (which has codified the common law).* Since the district court found and the record establishes that the Luxembourg affiliate, as the holder of the Swiss francs comprising the time deposit account, was notified of the New York Bank's interest in the account [Opinion, A 139, 141; Ex. H (E 186)], sufficient delivery occurred to establish a valid pledge of the time deposit.

The Trustee mistakenly relies on dictum in McCoy v. American Express Co., 253 N.Y. 477, 171 N.E. 749 (1930). In that case, no notice of the purported pledgee's interest was ever given to the third party holding the collateral

*Comment a. of §8 of the Restatement explains the rule as follows:

> "While ordinarily an agency cannot be created without consent of the agent (Restatement of Agency, §15) it is not considered desirable to require the consent of the third person [holding the collateral] as a condition precedent to the creation of a pledge. The third person's duties are not altered in any material respect by the pledge. To make the third person's consent a test of the creation of the pledge would invest him with an aribtrary power of affecting the interests of the other parties. The third person of course may surrender the possession if he does not wish to be under any duty to the pledgee."

An additional reason for not requiring the consent or attornment of the third party as in the ordinary case of an agency relationship is that the possession of the third party with notice of the pledgee's interest serves the purpose of putting creditors on notice of the pledgee's interest. Gins v. Mauser, supra. To require the third party to consent to the relationship with the pledgee does not further that purpose in any way.

as was done in the instant case. Thus, the court was not required to determine whether an agency relationship is necessary when notice is given.

B. The Trustee Erroneously Urges That Mail And Other Communications Could Have Effected A Transfer Of The Funds Without The Telex Key Code

The Trustee attempts to minimize the significance of the telex key code by emphasizing that the district court found that AIBC could have communicated with the Luxembourg affiliate without utilizing the telex test key code.* But as pointed out in our earlier brief and not rebutted by the Trustee, such means of communication could not have affected the disposition of the funds.

Mail and telephone communications frequently exist between a bank and a depositor. The question at issue is not whether AIBC could communicate with the Luxembourg affiliate but whether such communications could have affected "the enjoyment, transfer or enforcement of the deposit." The record contains no evidence that the time deposit could have been affected by any means other than the telex key code. The

*The Trustee contends that the New York Bank did not assert that the telex test key code constituted the equivalent of an indispensable instrument in the district court proceeding. Not only does the record contain evidence establishing without question that the New York Bank did raise the point below [Defendant's Post-Trial Memorandum of Law, pp. 8-19; Defendant's Post-Trial Reply Memorandum of Law, p. 7], but also the district court opinion specifically recognizes that such was the case. [Opinion, A 180, n. 13]

mail communication from the Luxembourg affiliate to AIBC cited by the district court did not involve the disposition of the funds. The communication referred to by the district court was simply a request for acknowledgement of the time deposit receipt mailed earlier. [Opinion, A 180, 181, n. 13; Ex. 4 (E 6)] Uncontradicted evidence does exist, however, that the telex key code possessed by the New York Bank was the only means by which the time deposit could be affected. [Testimony of Charles E. Lilien, Tr. pp. 251-53]* As such it was the indispensable instrument.

Potential creditors were protected. AIBC did not possess an indispensable instrument. For this reason, a creditor seeking to confirm AIBC's unencumbered interest in the time deposit was required to communicate with the bank holding the time deposit. Any reasonable creditor following this practice would have contacted the Luxembourg affiliate and would have been notified of the New York Bank's security interest.**

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*The Luxembourg affiliate had notice of the New York Bank's interest in the time deposit account. Communications from AIBC could not have affected the disposition of the funds unless they were confirmed by the New York Bank. In fact, if the Luxembourg affiliate had paid out any of the funds comprising the time deposit account, it would have subjected itself to liability since it had notice of the New York Bank's security interest. See, Myers v. Albany Savings Bank, supra; Brown v. Empire City Savings Bank, 23 Misc. 2d 1094, 203 N.Y.S. 2d 339 (Sup. Ct. 1960)

**It was the New York Bank's possession of the telex key code coupled with the fact that AIBC was not given an indispensable instrument that removed any opportunity for AIBC to mislead creditors and obtain a false credit.

C. The New York Bank Had The Right To Foreclose On The Time Deposit Account Pledged As Security

The Trustee makes the unsupported assertion that the New York Bank did not have a perfected pledge because it had no right to foreclose on the time deposit maintained with the Luxembourg affiliate. No case has been cited to support this startling proposition. The reason is clear. The right of foreclosure is an inherent right which follows from the fact that a party has a security interest in collateral.

The April 30 and May 2, 1973 letters gave the New York Bank a security interest in the time deposit. [Exs. 1 (E 1) A (E 174)] The Luxembourg affiliate was notified of this security interest and was holding the time deposit as the New York Bank's agent. This right of foreclosure was inherent in the New York Bank's security interest.

Furthermore, the Trustee has overlooked the General Pledge Agreement [Ex. F (E 181)] dated January 29, 1970. This agreement was signed by Silverston as president of AIBC. It explicitly provides for the acceleration of AIBC's indebtedness and foreclosure on any collateral in the New York Bank's possession:

> "Bank may declare immediately due and payable all indebtedness secured hereby and shall have all the rights and remedies provided by law. Any public sale may be held at any branch office of [the] Bank."

## POINT IV

### THE TRANSFER OF THE PROCEEDS OF THE LUXEMBOURG TIME DEPOSIT THROUGH INTERNATIONAL BANK CLEARING CHANNELS DID NOT DESTROY THE NEW YORK BANK'S SECURITY INTEREST

Crucial to the district court's opinion is the concept that regardless of the effectiveness of the pledge of the Luxembourg time deposit as security for the first loan, the continuity of possession was lost when the funds were telexed through international banking channels to the New York Bank. The court states:

> "Thus, whatever validity the pledge may have had while the Luxembourg Bank controlled the property, the pledge ceased to be perfected when the property came into the control of the Swiss Bank. While the interruption in possession was merely a temporary one, the fact remains that a judgment creditor of AIBC could have foreclosed on the Swiss Francs on November 2 while they were in the custody of the Swiss Bank. Moreover, had AIBC defaulted on its debt to the New York Bank on November 2 by issuing new and different instructions to the Swiss Bank, the defendant would not have had control over any pledged property with which to effect payment of the debt owed it." [Opinion, A 144]

The district court's conclusion that AIBC could have issued different instructions to SCB, and diverted the funds, is erroneous since the Luxembourg affiliate issued

the instructions at the direction of the New York Bank. The Trustee does not dispute that the bank transmitting funds is the agent of the sender. Here, the remittance instructions which controlled the transfer of the funds were issued by the Luxembourg affiliate which was the agent of the New York Bank:

> " Fr. 3,309,997.50 2.11
>
> Att. mr. Ribi. Instructions: remit dollar equivalent to Wells Fargo Bank Int. New York. Att. mr. William Boland" EX. AD (E221)

The very wording of these instructions had been dictated to the Luxembourg affiliate by the New York Bank.

> "WELLS FARGO BANK, LUXEMBOURG
>
> RE OUR TELEPHONE CONVERSATION 4/30/73 WE CONFIRM SWISS FRANCS TIME DEPOSIT 3,240,000 VALUE 5/3/73 PERIOD 182 DAYS MATURING NOVEMBER 2, 1973 RATE 4 1/8 PERCENT P.A. SWISS FRANCS WILL BE CREDITED YOUR ACCOUNT AT SWISS BANK CORP. ZURICH BY ORDER SWISS CREDIT BANK ZURICH BY ORDER AMERICAN I.B. C. 770 LEXINGTON AVE., N.Y. AT MATURITY PAY PRINCIPAL PLUS INTEREST TO SWISS CREDIT BANK ZURICH, ATTENTION MR. RIBI SWISS FRANCS 3,308,850 CREDIT DOLLAR EQUIVALENT 1,042,814.37 TO WFBI FOR ACCOUNT AMERICAN I.B.C. ATTENTION BOLAND." EX.A (175)
> [Emphasis supplied]

The district court's suggestion that AIBC could have diverted these funds is totally unsupported. The remittance instructions issued by the Luxembourg affiliate acting on behalf of the New York Bank controlled. In fact,

had SCB not followed these instructions it would have been liable to the New York Bank.

Even if SCB was not the agent of the New York Bank and its Luxembourg affiliate, the New York Bank's security interest was continuous. As the Trustee correctly concedes (Appellee's Brief, p. 63), and the district court specifically held [Opinion, A 182, n. 17], collateral may be returned to a pledgor or a third party for a temporary or special purpose without any loss on the part of the pledgee of his security interest. This includes releasing the pledged item for purposes of sale, or exchange as was done in the instant case.* Hickok v. Cowperthwait, 201 N.Y. 137, 143, 103 N.E. 1111 (1913); Fairbanks v. Sargent, 117 N.Y. 320, 334-45, 22 N.E. 1039 (1889); Harrison v. Merchants National Bank, 124 F.2d 871, 874-5 (8th Cir. 1942); Israel v. Woodruff, 299, F. 454, 456 (2d Cir. 1924); Restatement of Security, §11 (2) (1941). See also, McCoy v. American Express Co., 253 N.Y. 477, 483, 171 N.E. 749 (1930).

The Trustee cites McCoy v. American Express Co. for the proposition that a lien will be lost if a pledgee returns the collateral to the pledgor. However, the McCoy court

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*Both the letters dated April 30 [Ex. 1 (E 1)] and May 2, 1973 [Ex. A (E 174)] and the General Pledge Agreement [Ex. F (E 181)] provide for the release of the collateral (the time deposit) for the temporary or special purpose of sale or exchange.

recognized that there is a specific exception to this rule. In McCoy, the court stated:

> "Indeed a pledge, once acknowledged, may be lost if the chattel is put back without restriction in the hands of the pledgor though the result will be different if it is returned for a temporary or specific purpose." 253 N.Y. at 483 [Emphasis supplied]

In an attempt to avoid this rule, the Trustee contends that it is limited to instances where the party receiving the collateral for the temporary or specific purpose is the agent of the pledgee or subject to the pledgee's direct control. (Appellee's Brief, pp. 63-64). The Trustee has missed the point. The essence of the exception is that the collateral is returned for a temporary or specific purpose. It is from this fact that the courts have implied that the pledgor is the agent of the pledgee and under his control. In the present case, the Swiss franc proceeds of the time deposit were released for the temporary and specific purpose of exchanging them into dollars.

However, there is another fatal flaw in the Trustee's argument. The Swiss francs in the present case were not released to the pledgor, AIBC, but to a third party, SCB. The Trustee relies on cases which involved the return of the collateral to the pledgor, rather than to a third party. In these cases the courts were clearly concerned with the two possible meanings attached to the return of the collateral to the pledgor. Was the pledgee returning the collateral for a

limited and specific purpose only, or was the pledgee waiving or releasing his security interest in the collateral altogether? In an attempt to answer these questions, the courts created the implied agency concept to which the Trustee points in his brief.*

When, as in this case, a pledgee or his agent delivers the collateral to a party other than the pledgor, the risk that the pledgee is waiving or releasing his security interest does not exist. There is no need for determination of whether the third party is acting as the agent of the pledgee. It is sufficient to inquire whether the pledgee was releasing the collateral absolutely or whether the collateral was released for some specific or limited purpose as was the case in the instant transaction.

The district court's failure to recognize that notice to a third party is not necessary when collateral is being released for the temporary and specific purpose of sale or exchange is crucial to its decision.

> "Moreover, without regard to expiration of the time deposit, the assumed pledge was lost as [a] matter of law when the Swiss Francs were forwarded to the Swiss Bank without any notice of a pledge to the New York Bank. The Swiss Francs were then exchanged into dollars which were transmitted to New York by Swiss Bank." [Opinion, A 143]

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*The implied agency concept is really just another way of saying that the party receiving the collateral from the pledgee does not receive it absolutely but only for a special or limited purpose.

Notice of a security interest when collateral is temporarily delivered to a third party is not required. In Harrison v. Merchants National Bank, 124 F.2d 871 (8th Cir. 1942), discussed in Appellant's brief, there was no indication that the purchaser had notice of the bank's security interest or was the bank's agent. However, the court concluded that the release of the collateral by the bank did not result in a loss of its security interest.* See also Fairbanks v. Sargent, 117 N.Y. 320, 22 N.E. 1039 (1889).

The Trustee also attempts to cast doubt on the above principles of law by suggesting that since most of the cases involving the special or limited purpose doctrine were decided prior to the Chandler Amendment of 1938 the doctrine is suspect. It should be noted that in addition to the Harrison case, which was decided in 1942, the recently enacted Uniform Commercial Code contains a provision very similar to the special or limited purpose doctrine as set forth in the earlier decisions. N.Y. U.C.C. §9-305(5) (McKinneys 1964). In addition, Official Comment 2(b) to §9-306 of the U.C.C. states that if a party perfects his security interest in the proceeds of collateral by taking possession of the proceeds within 10 days, his security interest is deemed continuous for the purposes of §60 of the Bankruptcy Act.

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*The Trustee's attempt to distinguish Harrison because it was decided under Arkansas law is untenable. The court in Harrison states that the Arkansas decisions in this regard are consistent with the general principles of law in other states, including New York. 124 F.2d at 874.

## POINT V

### THE TIME DEPOSIT LOCATED AT THE LUXEMBOURG AFFILIATE WAS A "SPECIAL DEPOSIT" SIMILAR TO A TRUST. THEREFORE PAYMENT OF THE PROCEEDS TO THE NEW YORK BANK DID NOT CONSTITUTE A PREFERENCE

The facts and issues in the instant case are virtually identical to those in the recent case of Creel v. Birmingham Trust National Bank, 383 F. Supp. 871 (N.D. Ala. 1974), aff'd, 510 F.2d 1363 (5th Cir. 1975). In Creel, the court, characterizing the case as one of first impression, held that funds deposited by a debtor in a bank account for the purpose of securing a debt owed to two creditors did not pass to the trustee in bankruptcy. Similarly, the court held that payments made from such account to the two creditors within four months of bankruptcy were not voidable preferences. The rationale for such holdings was that the bank account, being for a specific purpose, was in the nature of a trust.

The Trustee in an attempt to distinguish the undistinguishable misstates the facts of Creel in three significant respects. First, the Trustee states that the bank account in Creel was established as an irrevocable trust. Nowhere in the opinion is there a basis for that statement. In fact, the court in Creel specifically held that the creation and designation of a bank account for a special purpose, i.e., to serve as security for money owed, will be treated as a trust even though the parties never contemplated the

creation of a trust. 383 F. Supp. at 875. Second, the Trustee asserts that the voidable preference question was not an issue in the case. The Creel opinion specifically indicates otherwise. 383 F. Supp. at 872, 873, 880. In addition, the Trustee describes the bank account as "unique." No support is found for such a characterization in the court's opinion. In fact, the abundance of authorities cited by the court relating to deposits created for a special purpose establishes just the opposite.

The Trustee attempts to minimize the significance of Creel by arguing that the New York courts would decide the Creel case differently if faced with the issue. In support of this contention the Trustee relies exclusively on Curry v. Powers, 70 N.Y. 212 (1877). Such authority, however, is totally misplaced.

In Curry, unlike the present case, the purported transferor never had any intent to transfer a present interest in the bank account. Moreover, no indication or notice was ever given to the bank holding the account, that the transferor ever intended that the bank account was for a special purpose. In such circumstances, a trust theory was properly rejected as a cure-all for an incompleted gift.

In the instant case, however, it is clear, as the district court found, that the parties intended that AIBC would transfer a present interest in the bank account to the New York Bank for security purposes. [Opinion, A 138].

Furthermore, the bank holding the account, the Luxembourg affiliate was notified of the special purpose that the account was to serve. [Opinion, A 139, 141; Ex. H (E 185); Tr. p. 155]. In such circumstances, pursuant to the Creel case, treating the account as a trust is quite appropriate, even where the parties never used the word "trust" in setting up the account.

The Trustee also suggests that no New York authority supports the result reached in Creel. To the contrary, however, the test of whether a deposit is special under New York law is the same as that ennunciated in the Creel case, i.e., whether the deposit is made for a special purpose. 5A N.Y. Juris., Banks and Trust Co. §275 at 35-36 (1975). See also Brown v. J. P. Morgan & Co., 295 N.Y. 867, 67 N.E. 2d 263 (1946) (deposit setting aside amounts for called bonds); In re Associated Gas & Elec. Co., 137 F.2d 607 (2d Cir. 1943) (funds deposited to pay dividends); Cutler v. American Exchange National Bank, 113 N.Y. 593, 21 N.E. 710 (1889) (deposit for purpose of transmitting funds to another at a distant place); Rogers Locomotive and Machine Works v. Kelly, 88 N.Y. 234 (1882) (deposit to pay certain coupon bonds).

## POINT VI

### UNDER SECTION 60 OF THE BANKRUPTCY ACT A LIEN IS SUFFICIENT TO CONSTITUTE A TRANSFER OF THE DEBTOR'S PROPERTY. AN OUTRIGHT ASSIGNMENT IS NOT REQUIRED

The Trustee misstates appellant's analysis, discussed in our main brief, showing that payment of the second loan did not diminish the bankrupt's estate and therefore did not constitute a preference. The district court's holding that a transfer to Swiss Credit Bank did not take place on August 29, 1973 is premised on the completely erroneous proposition that an assignment was required.* The law requires only a lien for a transfer under §60 of the Bankruptcy Act. Appellant's Brief, Point IV.

The Trustee now attempts to divert attention from this analysis of the law by briefing the question whether there was or was not an assignment. But whether an outright assignment occurred under Swiss law is simply not the test and is totally irrelevant. The Bankruptcy Act sets forth the test in no uncer-

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*The court found there was no assignment. It relied upon the affidavit of appellee's Swiss law expert, Dr. Werner de Capitani. Dr. de Capitani is "an attorney admitted to the Bar of the Canton of Zurich (Switzerland) and has been practicing in Zurich for 14 years. I am fully conversant with Swiss Law." That is the extent of his stated qualifications as an expert. Quite apart from Mr. de Capitani's qualifications as an expert (or lack thereof) the affidavit does not set forth his actual occupation, namely that of inhouse legal counsel for SCB. SCB is hardly in a position to supply disinterested legal expertise, as it was first of all the claimant to the proceeds of the second loan repayment and it is currently a major creditor of AIBC.

tain terms, i.e., whether the transfer---"became so far perfected that no subsequent lien--could become superior to the rights of the transferee--". Bankruptcy Act §60 a(2), 11 U.S.C. §96 a(2) (1970).

In the uncontroverted expert opinion of the Swiss counsel provided by the appellant below, SCB on August 29, 1973 acquired "a lien and a right of set-off on the dollar proceeds of AIBC's foreign exchange contract and . . . no third party could have obtained an interest in those dollars superior to that of the Swiss Bank after August 29, 1973."* (Opinion, A 170) As the New York Bank pointed out in its initial brief, this is precisely the test under §60 a(2) of the Bankruptcy Act for determining when a transfer of the debtor's property has occurred.

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*The result would be the same under New York law. As the district court correctly points out, the August 29th telex satisfies the criteria for an assignment under the common law rule (Opinion, A 191). In spite of this fact, the court suggests that it might not be an assignment because the obligor (SCB) is also the assignee (SCB). Technically, this transaction might be more accurately referred to as a waiver by AIBC of its contract right to receive dollars from SCB. The fact that this is a waiver rather than an assignment does not change the result. In any event, the test should be an easier one when both the obligor (SCB) and the assignee (SCB) are the same. The district court has made a distinction without a difference for which it has failed to cite any authority. Furthermore, under New York law, SCB had the additional security of the UCB time deposit. In June and July of 1973 UCB was "irrevocably" instructed by AIBC to transfer the Swiss franc proceeds of the time deposit to SCB. [Ex. 40 (E 140)] Under the district court's own test for an assignment, these "irrevocable" instructions constituted an assignment. Therefore, just as the New York Bank was secured in the first transaction under New York law by the time deposit located at the Luxembourg affiliate, SCB in the second transaction was secured by the time deposit located at UCB. As has already been pointed out, the filing requirements of the UCC are inapplicable to bank accounts.

The Trustee's contention and the district court's holding that SCB's lien status was not sufficient to constitue a transfer under §60 of the Bankruptcy Act flies in the face of the clear language of the statute and all precedent. The fact that AIBC may have retained nominal title to the funds until SCB's lien ripened into possession on November 19, 1973 is simply irrelevant. (Appellant's Brief, p. 41)

The Trustee next argues that SCB's lien never ripened to the point where it had actual possession of the funds on November 19, 1973. (Appellee's Brief, pp. 75-76) The Trustee's contention that SCB did not have possession of the funds was properly rejected by the district court:

> ". . .[T]he alleged assignment to the Swiss Bank need not have been affected prior to November 19 for the funds to be considered the Swiss Bank's property, perfection was accomplished on that date when the Swiss Bank obtained possession of the assigned funds." (Opinion, A 138 n. 18) [Emphasis supplied]*

Since SCB was transferring its own dollars to the New York Bank (dollars that could not be recovered by the

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*The district court, of course, was incorrect in its failure to recognize that for the purpose of the Bankruptcy Act, the transfer must be deemed to have occurred when SCB acquired its lien on August 29, 1973. Appellant's brief, p. 41; In re King-Porter Co., 446 F. 2d 722, 730 (5th Cir. 1971)

Trustee in Bankruptcy), In re Erie Forge & Steel Corp., 456 F. 2d 801 (3rd Cir. 1972), is directly on point.

However, even if we were to assume for the sake of argument only that the dollars did not become the property of SCB on November 19, 1973, there still would have been no diminution of the debtor's estate because the liens of SCB and the New York Bank were continuous. Ricotta v. Burns Coal & Building Supply Co., 245 F. 2d 749 (2nd Cir. 1959). See also Opinion, A 190; In re Erie Forge & Steel Corp., supra, Bertram v. Citizens National Bank, 283 F. 2d 783 (6th Cir. 1960); U.C.C. §9-302(2); 3 Collier Bankruptcy ¶60.51A at 1050.11 (14th ed. 1974); Appellant's brief, p. 42 n. 1. SCB's lien began on August 29, 1973 and was continuous until the Chase Manhattan Bank released the dollars on behalf of SCB to the New York Bank. The New York Bank immediately acquired a lien pursuant to either "the 1970 Agreement" [Exhibit F (E 181)] or the Bank's right of set-off. Hamm v. Hamm, 87 N.Y.S. 2d 47 (Sup. Ct. 1949). The liens were continuous at all times and the estate of the debtor was not diminished.

The district court suggests that SCB's lien was lost when it transferred the dollars to the New York Bank because "the Swiss Bank did not place the dollars with the New York Bank as an investment of AIBC's funds still on deposit with it." While it is not clear what this statement means,

it is clear that it is irrelevant. Regardless of what reason SCB had for transferring the funds, the moment its lien lapsed, the New York Bank's lien attached.

The Trustee, however, contends that these continuous liens were broken when the New York Bank credited and simultaneously debited the dollars from AIBC's account (Appellee's Brief, p. 77). It was precisely this question that was determined in McKenzie v. Irving Trust Co., 292 N.Y. 347, 357 (1944) aff'd, 323 U.S. 365, 371-72 (1945). In that decision relied on by the district court, the New York Court of Appeals held that bookkeeping entries of this type made to reflect a loan repayment do not constitute a return of the funds to the bankrupt for the purpose of §60 of the Bankruptcy Act.

In McKenzie, a debtor mailed a check to a creditor bank more than four months before his bankruptcy petition. The check was received by the bank within the four month period. The bank credited the funds to the debtor's account and then immediately debited the account in repayment of the loan it had made to the debtor. The Trustee argued that these credit entries constituted a return of the funds to the bankrupt's estate and that when the account was debited there was a preference because this occurred within the four month period. This argument, which is identical to that presented by the Trustee in the present case, was rejected by the Court.

Therefore, regardless of whether SCB's lien ripened into possession of the actual funds on November 19, 1973 or the liens of SCB and the New York Bank were continuous, the result is the same. When the New York Bank applied the dollars in payment of the loan on November 19, 1973 there was no diminution of American IBC's estate. All that happened was that one creditor was substituted for another. The balance sheet of AIBC remained unaffected.

## CONCLUSION

For the reasons stated in this brief the district court's decision should be reversed.

Respectfully submitted,

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